

# B U S I N E S S S I T U A T I O N

Larry R. Moran prepared the first section of this article, and Daniel Larkins prepared the section on corporate profits.

**R**EAL GROSS domestic product (GDP) increased 3.1 percent in the third quarter of 1997, according to the “final” estimates of the national income and product accounts (NIPA’s).<sup>1</sup> The third-quarter increase in GDP was about the same as the 3.3-percent increase in the second quarter (chart 1). Accelerations in consumer spending and in business fixed investment nearly offset a sharp downturn in business inventory investment, a larger decrease in net exports in the third quarter than in the second, and decelerations in residential investment and in government spending (table 1).

The “final” estimate of the change in real GDP is 0.2 percentage point lower than the 3.3-percent increase indicated by the “preliminary”

estimate reported in the December “Business Situation” (table 2). The revision is slightly less than the average revision—0.3 percentage-point, without regard to sign—from the preliminary to the final estimate for 1981–96. Revisions to the components of GDP were small. Downward revisions to nonfarm business inventory investment, consumer spending, and net exports more than offset an upward revision to business fixed investment. The revision to business inventory investment was primarily to manufacturers’ durable goods inventories and reflected the incorporation of revised data on inventory book values for September. In consumer spending, the largest revision was to services and primarily reflected the incorporation of newly available data on hospital expenses. In net exports, the incorporation of revised data on trade in goods and services resulted in a larger upward revision to imports than to exports. In business fixed investment, the

1. Quarterly estimates in the NIPA’s are expressed at seasonally adjusted annual rates unless otherwise specified. Quarter-to-quarter dollar changes are differences between published estimates. Quarter-to-quarter percent changes are annualized and are calculated from unrounded data. Real estimates are expressed in chained (1992) dollars, and price indexes are chain-type indexes.

**Table 1.—Real Gross Domestic Product, Real Gross Domestic Purchases, and Real Final Sales to Domestic Purchasers**

[Seasonally adjusted at annual rates]

	Billions of chained (1992) dollars					Percent change from preceding quarter			
	Level	Change from preceding quarter				1996		1997	
	1997	1996	1997						
	III	IV	I	II	III	IV	I	II	III
<b>Gross domestic product</b> .....	<b>7,214.0</b>	<b>73.6</b>	<b>84.2</b>	<b>58.0</b>	<b>54.4</b>	<b>4.3</b>	<b>4.9</b>	<b>3.3</b>	<b>3.1</b>
Less: Exports of goods and services .....	973.0	49.7	21.6	39.8	10.5	25.5	9.9	18.4	4.4
Plus: Imports of goods and services .....	1,137.1	16.4	42.3	50.2	38.0	6.8	17.9	20.5	14.6
<b>Equals: Gross domestic purchases</b> .....	<b>7,364.6</b>	<b>43.1</b>	<b>102.5</b>	<b>66.0</b>	<b>77.7</b>	<b>2.5</b>	<b>5.9</b>	<b>3.7</b>	<b>4.3</b>
Personal consumption expenditures .....	4,896.2	38.2	61.7	11.3	66.8	3.3	5.3	.9	5.6
Durable goods .....	656.1	5.2	20.7	-8.8	27.1	3.5	14.1	-5.4	18.4
Nondurable goods .....	1,465.5	7.3	16.6	-7.8	15.5	2.1	4.7	-2.1	4.3
Services .....	2,776.1	25.4	25.7	25.9	26.3	3.9	3.9	3.9	3.9
Gross private domestic fixed investment .....	1,149.3	7.8	10.3	32.4	37.9	3.0	3.9	12.6	14.4
Nonresidential .....	874.5	11.5	8.1	28.1	37.5	5.9	4.1	14.6	19.2
Structures .....	196.7	6.9	-1.0	-2.4	3.2	15.3	-2.1	-4.7	6.7
Producers’ durable equipment .....	685.3	3.8	9.9	32.7	36.0	2.6	6.7	23.0	24.1
Residential .....	280.1	-3.0	2.2	4.9	1.9	-4.3	3.3	7.4	2.7
Change in business inventories .....	47.5	-5.0	30.8	13.9	-30.1	.....	.....	.....	.....
Nonfarm .....	9.5	-1	-1.1	2.2	2.0	.....	.....	.....	.....
Farm .....	38.3	-5.1	31.8	11.8	-31.8	.....	.....	.....	.....
Government consumption expenditures and gross investment .....	1,273.4	.3	-1.3	9.6	3.3	.1	-4	3.1	1.1
Federal .....	458.8	-6.1	-6.8	7.3	-1.3	-5.2	-5.8	6.6	-1.1
National defense .....	310.3	-5.8	-9.7	5.5	.9	-7.1	-11.8	7.5	1.2
Nondefense .....	148.0	-3	2.8	1.7	-2.2	-1.0	8.0	4.9	-5.7
State and local .....	814.7	6.4	5.4	2.4	4.6	3.3	2.7	1.2	2.3
<b>Addendum: Final sales to domestic purchasers</b> .....	<b>7,310.9</b>	<b>46.3</b>	<b>70.4</b>	<b>51.6</b>	<b>106.2</b>	<b>2.7</b>	<b>4.0</b>	<b>2.9</b>	<b>6.0</b>

NOTE.—Chained (1992) dollar series are calculated as the product of the chain-type quantity index and the 1992 current-dollar value of the corresponding series, divided by 100. Because the formula for the chain-type quantity indexes uses weights of more than one period, the corresponding chained-dollar estimates usually are not additive. Chained (1992) dollar levels and residuals,

which measure the extent of nonadditivity in each table, are found in NIPA tables 1.2, 1.4, and 1.6. Percent changes are calculated from unrounded data. Percent changes in major aggregates are found in NIPA table 8.1.

upward revision was to structures and reflected the incorporation of revised data on the value of nonresidential construction put in place for September.

Real final sales of domestic product increased 4.7 percent in the third quarter, 0.2 percentage point less than the preliminary estimate.<sup>2</sup> The revision was the same as that to GDP because the revision to change in business inventories was small.

Real gross domestic purchases increased 4.3 percent, 0.2 percentage point less than the preliminary estimate. The revision was the same as that to GDP because the revision to net exports was small.

2. Final sales of domestic product equals GDP less change in business inventories.

**Table 2.—Revisions to Real Gross Domestic Product and Prices, Third Quarter 1997**

(Seasonally adjusted at annual rates)

	Percent change from preceding quarter		Final estimate minus preliminary estimate	
	Preliminary estimate	Final estimate	Percentage points	Billions of chained (1992) dollars
<b>Gross domestic product</b> .....	<b>3.3</b>	<b>3.1</b>	<b>-0.2</b>	<b>-3.6</b>
Less: Exports of goods and services .....	4.3	4.4	.1	.3
Goods .....	3.8	3.4	-.4	-.7
Services .....	5.7	7.2	1.5	.8
Plus: Imports of goods and services .....	14.0	14.6	.6	1.4
Goods .....	14.8	15.4	.6	1.2
Services .....	9.5	10.1	.6	.2
<b>Equals: Gross domestic purchases</b> .....	<b>4.5</b>	<b>4.3</b>	<b>-.2</b>	<b>-2.6</b>
Personal consumption expenditures .....	5.8	5.6	-.2	-1.7
Durable goods .....	18.2	18.4	.2	.2
Nondurable goods .....	4.4	4.3	-.1	-.4
Services .....	4.1	3.9	-.2	-1.4
Fixed investment .....	13.9	14.4	.5	1.1
Nonresidential .....	18.1	19.2	1.1	2.0
Structures .....	3.3	6.7	3.4	1.6
Producers' durable equipment .....	24.1	24.1	0	0
Residential .....	3.7	2.7	-1.0	-.7
Change in business inventories .....	.....	.....	.....	-2.0
Nonfarm .....	.....	.....	.....	-2.3
Farm .....	.....	.....	.....	-.3
Government consumption expenditures and gross investment .....	1.1	1.1	0	-.2
Federal .....	-1.0	-1.1	-.1	-.1
National defense .....	1.3	1.2	-.1	-.1
Nondefense .....	-5.4	-5.7	-.3	-.2
State and local .....	2.3	2.3	0	0
<b>Addenda:</b>				
Final sales of domestic product .....	4.9	4.7	-.2	-1.8
Gross domestic purchases price index <sup>1</sup> .....	1.3	1.3	0	.....
GDP price index <sup>1</sup> .....	1.5	1.4	-.1	.....

1. Based on chained-type annual (1992) weights.

NOTE.—The final estimates for the third quarter of 1997 incorporate the following revised or additional major source data that were not available when the preliminary estimates were prepared.

*Personal consumption expenditures:* Revised retail sales for September and newly available data on used auto sales and stocks for August and September.

*Nonresidential fixed investment:* Revised construction put in place for August and September and revised manufacturers' shipments of machinery and equipment for September.

*Residential fixed investment:* Revised construction put in place for August and September.

*Change in business inventories:* Revised manufacturing and trade inventories for September.

*Exports and imports of goods and services:* Revised data on exports and imports of goods for September and revised balance-of-payments data on exports and imports of services for the second and third quarters.

*Government consumption expenditures and gross investment:* Revised State and local construction put in place for August and September.

*Wages and salaries:* Revised employment, average hourly earnings, and average weekly hours for September.

*GDP prices:* Revised export and import prices for July through September and revised prices of single-family homes under construction for the third quarter.

The price index for gross domestic purchases increased 1.3 percent, the same as the preliminary estimate, and the price index for GDP increased 1.4 percent, 0.1 percentage point less than the preliminary estimate.

Real disposable personal income increased 2.6 percent, 0.1 percentage point less than the preliminary estimate; the revision was primarily to personal interest income and reflected newly available flow-of-funds data and data on interest received and paid by commercial banks. The personal saving rate was 3.5 percent, the same as the preliminary estimate.

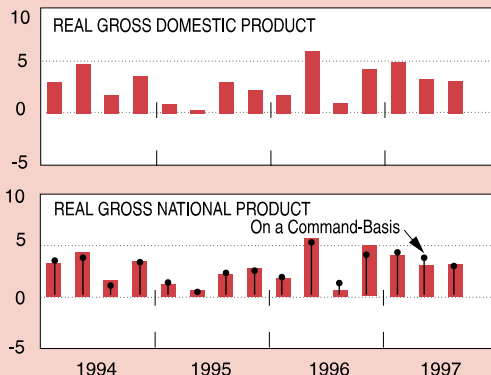
**Gross national product (GNP).**—Real GNP increased 3.1 percent in the third quarter, the same as real GDP (chart 1 and table 3).<sup>3</sup> Receipts of factor income from the rest of the world and payments of factor income to the rest of the world increased about the same amount; interest income accounted for more than two-thirds of the increase in receipts and about three-fifths of the increase in payments. The revised estimate of the third-quarter growth in real GNP is 0.5 percentage point higher than the preliminary estimate, reflecting an upward revision to profits from the rest of the world (see the discussion about revisions in the section on "Corporate Profits").

3. GNP—goods and services produced by labor and property supplied by U.S. residents—equals GDP plus receipts of factor income from the rest of the world less payments of factor income to the rest of the world.

**CHART 1**

### Selected Product Measures: Change From Preceding Quarter

Percent



Note.—Percent change at annual rate from preceding quarter; based on seasonally adjusted estimates.

U.S. Department of Commerce, Bureau of Economic Analysis

**Table 3.—Relation of Real Gross Domestic Product, Real Gross National Product, and Real Command-Basis Gross National Product**

[Seasonally adjusted at annual rates]

	Billions of chained (1992) dollars			Percent change from preceding quarter	
	Level	Change from preceding quarter		1997	
	1997	1997			
	III	II	III	II	III
<b>Gross domestic product</b> .....	<b>7,214.0</b>	<b>58.0</b>	<b>54.4</b>	<b>3.3</b>	<b>3.1</b>
Plus: Receipts of factor income from the rest of the world .....	242.5	11.7	6.2	22.4	10.9
Less: Payments of factor income to the rest of the world .....	256.9	16.8	6.1	31.8	10.1
<b>Equals: Gross national product</b> .....	<b>7,198.8</b>	<b>52.6</b>	<b>54.4</b>	<b>3.0</b>	<b>3.1</b>
Less: Exports of goods and services and receipts of factor income from the rest of the world .....	1,216.0	51.6	17.1	19.3	5.8
Plus: Command-basis exports of goods and services and receipts of factor income .....	1,261.9	69.8	20.2	26.0	6.7
<b>Equals: Command-basis gross national product</b> .....	<b>7,244.8</b>	<b>70.8</b>	<b>57.6</b>	<b>4.0</b>	<b>3.2</b>
<b>Addendum:</b>					
Terms of trade <sup>1</sup> .....	103.8	1.5	.2	6.0	.8

1. Ratio of the implicit price deflator for the sum of exports of goods and services and of receipts of factor income to the corresponding implicit price deflator for imports with the decimal point shifted two places to the right.

NOTE.—Levels of these series are found in NIPA tables 1.10 and 1.11.

Real GNP on a command basis increased slightly more than real GNP in the third quarter—3.2 percent, compared with 3.1 percent—reflecting a slight improvement in the terms of trade.<sup>4</sup> In the second quarter, command-basis GNP increased considerably more than real GNP—4.0 percent, compared with 3.0 percent—reflecting a substantial improvement in the terms of trade.

## Corporate Profits

Profits from current production increased \$32.2 billion in the third quarter after increasing \$15.5 billion in the second (table 4).<sup>5</sup> Profits of

4. In the estimation of command-basis GNP—a measure of the goods and services produced by the U.S. economy in terms of their purchasing power—the current-dollar value of the sum of exports of goods and services and of receipts of factor income is deflated by the implicit price deflator for the sum of imports of goods and services and of payments of factor income.

The terms of trade is a measure of the relationship between the prices that are received by U.S. producers for exports of goods and services and the prices that are paid by U.S. purchasers for imports of goods and services. It is measured by the following ratio, with the decimal point shifted two places to the right: In the numerator, the implicit price deflator for the sum of exports of goods and services and of receipts of factor income; in the denominator, the implicit price deflator for the sum of imports of goods and services and of payments of factor income. Changes in the terms of trade reflect the interaction of several factors, including movements in exchange rates, changes in the composition of the traded goods and services, and changes in producers' profit margins. For example, if the U.S. dollar depreciates against a foreign currency, a foreign manufacturer may choose to absorb this cost by reducing the profit margin on the product it sells to the United States, or it may choose to raise the price of the product and risk a loss in market share.

5. Profits from current production is estimated as the sum of profits before tax, the inventory valuation adjustment, and the capital consumption

domestic industries increased \$33.1 billion after increasing \$12.2 billion. Profits of domestic non-financial corporations increased much more in the third quarter than in the second; the third-quarter increase reflected increases both in real output and in unit profits. Profits of domestic financial corporations increased slightly in both quarters. Profits from the rest of the world decreased \$0.9 billion after increasing \$3.4 billion; receipts slowed much more than payments.<sup>6</sup>

Cash flow from current production, a profits-related measure of internally generated funds available for investment, increased \$17.7 billion after increasing \$11.3 billion. The ratio of cash flow to nonresidential fixed investment, an indicator of the share of the current level of investment that

adjustment; it is shown in NIPA tables 1.9, 1.14, 1.16, and 6.16c (which are part of the "Selected NIPA Tables" that begin on page D-2 of this issue) as corporate profits with inventory valuation and capital consumption adjustments.

6. Profits from the rest of the world is calculated as (1) receipts by U.S. residents of earnings from their foreign affiliates plus dividends received by U.S. residents from unaffiliated foreign corporations minus (2) payments by U.S. affiliates of earnings to their foreign parents plus dividends paid by U.S. corporations to unaffiliated foreign residents. These estimates are derived from BEA's international transactions accounts.

**Table 4.—Corporate Profits**

[Seasonally adjusted at annual rates]

	Level	Change from preceding quarter			
	1997	1997			
	III	IV	I	II	III
	Billions of dollars				
<b>Profits from current production</b> .....	<b>827.3</b>	<b>8.2</b>	<b>31.8</b>	<b>15.5</b>	<b>32.2</b>
Domestic industries .....	727.5	-7.5	41.9	12.2	33.1
Financial .....	109.3	-16.1	28.3	.9	1.6
Nonfinancial .....	618.2	8.4	13.7	11.3	31.5
Rest of the world .....	99.9	15.7	-10.1	3.4	-9
Receipts (inflows) .....	150.5	9.2	-2.7	8.4	2.2
Payments (outflows) .....	50.6	-6.6	7.5	5.0	3.1
IVA .....	3.6	6.0	.2	2.4	-2.3
CCAdj .....	70.3	1.2	3.3	1.7	.9
Profits before tax .....	753.4	.9	28.4	11.4	33.6
Profits tax liability .....	258.2	-5.6	15.2	3.3	13.7
Profits after tax .....	495.2	6.5	13.2	8.1	19.9
Cash flow from current production .....	707.9	16.8	4.3	11.3	17.7
<b>Profits by industry:</b>					
Corporate profits with IVA .....	757.1	7.0	28.5	13.8	31.4
Domestic industries .....	657.2	-8.8	38.7	10.4	32.3
Financial .....	119.4	-15.9	28.4	1.0	1.9
Nonfinancial .....	537.8	7.1	10.2	9.4	30.4
Manufacturing .....	240.4	-8	-1.5	12.8	19.4
Transportation and public utilities .....	90.0	-7	1.0	-1.9	.4
Wholesale trade .....	54.1	9.7	1.6	.5	4.6
Retail trade .....	57.9	-2.3	6.8	-2	3.0
Other .....	95.3	1.3	2.3	-1.8	2.9
Rest of the world .....	99.9	15.7	-10.1	3.4	-9
	Dollars				
<b>Unit price, costs, and profits of nonfinancial corporations:</b>					
Unit price .....	1.072	.001	.004	.003	0
Unit labor cost .....	.695	.002	.004	.001	-.003
Unit nonlabor cost .....	.228	-.001	-.001	0	-.001
Unit profits from current production .....	.149	.001	.001	.001	.005

NOTE.—Levels of these and other profits series are found in NIPA tables 1.14, 1.16, 6.16c, and 7.15.

IVA Inventory valuation adjustment

CCAdj Capital consumption adjustment


could be financed by internally generated funds, decreased to 81.2 percent from 82.5 percent. The third-quarter ratio is in the lower part of the range in which the ratio has fluctuated during most of this decade.

**Industry profits.**—Industry profits increased \$31.4 billion after increasing \$13.8 billion.<sup>7</sup> Profits of domestic financial corporations increased slightly, as they had in the second quarter. Profits of domestic nonfinancial corporations increased almost three times as much as in the second quarter. All of the major industry groups contributed to the step-up. In manufacturing, profits in motor vehicle manufacturing and in petroleum turned up. Profits both in wholesale and in retail trade increased after little change, and profits both in “other” nonfinancial corporations and in “transportation and utilities” increased after a decrease.

**Related measures.**—Profits before tax (PBT) increased \$33.6 billion after increasing \$11.4 billion.

7. Industry profits are estimated as the sum of corporate profits before tax and the inventory valuation adjustment; they are shown in NIPA table 6.16C (on page D-16 of this issue). Estimates of the capital consumption adjustment do not exist at a detailed industry level; they are available only for total financial and total nonfinancial industries.

The difference between the \$22.2 billion step-up in PBT and the \$16.7 billion step-up in profits from current production was mainly accounted for by inventory profits, which increased after decreasing.<sup>8</sup>

**Revisions.**—The “final” estimate of a \$32.2 billion increase in profits from current production in the third quarter is \$11.1 billion more than the “preliminary” estimate released last month. This large revision was mostly accounted for by profits from the rest of the world—mainly receipts of profits from foreign affiliates of U.S. corporations—and was based on revised source data from the U.S. balance of payments accounts. In domestic profits, upward revisions to the profits of the transportation and utilities group and to profits of wholesale and retail trade were largely offset by a downward revision to profits of manufacturing industries. 

8. As prices change, companies that value inventory withdrawals at original acquisition (historical) costs may realize inventory profits or losses. Inventory profits—a capital-gains-like element in profits—result from an increase in inventory prices, and inventory losses—a capital-loss-like element in profits—result from a decrease in inventory prices. In the NIPA’s, inventory profits or losses are shown as adjustments to business income (corporate profits and proprietors’ income); they are shown as the inventory valuation adjustment with the sign reversed.